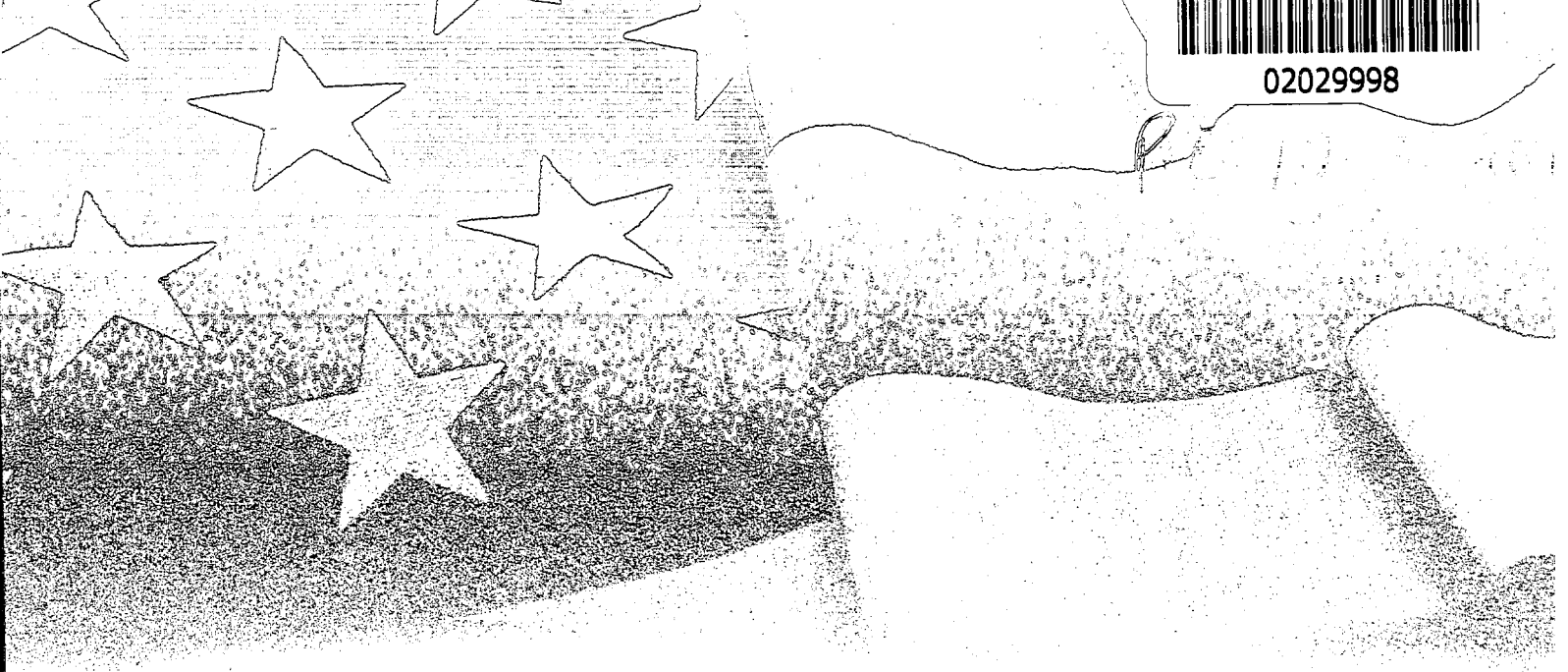




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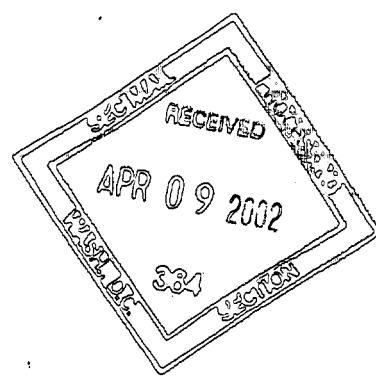


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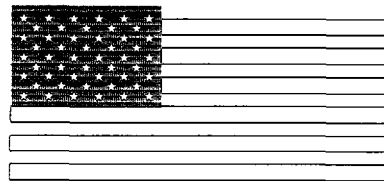
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*North Bancorp, Inc.*  
2001 ANNUAL REPORT

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# Selected Financial Data *Unaudited*

000s omitted, except per share data.  
At or for the Year Ended December 31.

	2001	2000	1999	1998	1997
<b>Selected Financial Condition Data:</b>					
Assets	\$ 187,800	\$ 133,279	\$ 91,226	\$ 65,617	\$ 60,632
Loans	157,106	111,036	71,835	45,085	47,898
Deposits	136,618	85,652	64,139	60,529	54,225
Borrowed funds	39,271	40,252	21,555	491	1,839
Stockholders' equity	10,798	5,987	4,456	3,893	3,608
<b>Selected Operations Data:</b>					
Interest income	\$ 13,521	\$ 9,712	\$ 5,871	\$ 5,021	\$ 4,738
Interest expense	(7,168)	(5,057)	(2,407)	(2,048)	(1,916)
Net interest income	6,353	4,655	3,464	2,973	2,822
Provision for loan losses	(886)	(523)	(300)	(430)	(84)
Net interest income after provision for loan losses	5,467	4,132	3,164	2,543	2,738
Other income	1,332	896	808	649	650
Other expenses	(4,686)	(3,379)	(2,801)	(2,745)	(2,746)
Federal income tax expense	(697)	(534)	(357)	(124)	(224)
Net income	\$ 1,416	\$ 1,115	\$ 814	\$ 323	\$ 418
<b>Per Share Data (1):</b>					
Earnings per share	\$ 3.12	\$ 3.57	\$ 2.63	\$ 1.04	\$ 1.35
Book value	\$ 20.56	\$ 18.20	\$ 14.38	\$ 12.55	\$ 11.63
Dividends per share	\$ 0.40	\$ 0.33	\$ 0.30	\$ 0.20	\$ 0.04
Weighted average shares outstanding	454,486	312,157	309,670	310,577	309,630
Actual shares outstanding	525,295	329,007	309,772	310,235	310,270
<b>Other Data:</b>					
Net interest margin	4.26 %	4.43 %	5.03 %	5.26 %	5.28 %
Net interest rate spread	3.61 %	3.76 %	4.41 %	4.62 %	4.60 %
Allowance for loan losses to total loans	0.78 %	0.76 %	0.81 %	0.95 %	0.98 %
Nonperforming loans to total loans	0.52 %	0.13 %	0.11 %	0.38 %	0.24 %
Efficiency ratio	60.98 %	60.87 %	65.57 %	75.79 %	79.09 %
Return on average assets	0.90 %	1.00 %	1.05 %	0.51 %	0.72 %
Return on average equity	15.80 %	22.25 %	19.50 %	8.61 %	11.88 %
Dividend payout ratio	12.82 %	9.24 %	11.41 %	19.23 %	2.96 %
Average equity to average assets	5.70 %	4.49 %	5.56 %	6.02 %	6.08 %

(1) Adjusted for the 5-for-4 stock split declared March 24, 2000 and the 2-for-1 stock split declared June 23, 2000.



*John Kluck, President*

It is appropriate to review our accomplishments as we close the book on 2001. More importantly, we can look forward and see what is in store for North Bancorp in 2002. Overriding all the business strategies and challenges we face, however, is our renewed sense of what is really important in life. The attacks of September 11, 2001 revitalized a sense of purpose beyond business goals. Our country experienced reinvigorated patriotism that will make us stronger. Our annual report reflects the patriotism that all associates of North Bancorp feel and honors all the men and women who gave, as Abraham Lincoln described, "the last full measure of devotion" to our country.

Before and after September 11th, we have followed President Bush's call to live our lives, uphold the values of America and participate and remain confident in the American economy. Faced with a weakened economy that forced interest rates down over four percentage points, we were able to achieve record earnings for the year, totaling \$1.4 million. Return on average shareholders' equity was 15.80%.

We addressed many challenges and changes that left us stronger. One of the biggest challenges we faced was to raise capital to support our continuing growth. In June we completed a \$4.3 million stock offering. I am grateful to all the existing shareholders who purchased additional shares. Your confidence and support throughout the years have been critical to our success. I also thank and welcome the 350 new shareholders who joined our family. The whole North Bancorp staff works to produce superior returns for our shareholders and I'm confident that you will not be disappointed.

The growth we experienced also represented a big change. Total assets and gross loans grew 41% in 2001, ending the year at almost \$188 million and \$157 million, respectively. Our personalized service, based on local decision-making capabilities, has attracted a substantial number of new customers to our bank. Our freedom to innovate, based on our customers' needs, is a tremendous advantage in the local marketplace. We intend to continually improve those services to further capitalize on new opportunities.

I firmly believe that we are experiencing a change in consumer attitudes toward banking companies. Big banking organizations have developed efficient organizations that are highly profitable. Yet, it is difficult to deliver personalized service to customers when an organization is spread across multi-state geographic areas. The resurgence of community banks is a manifestation of the desire for service tailored to individual needs.

While we have benefited from this opportunity, we are not standing still. We have taken steps to increase our service capabilities. We installed a digital check imaging system that greatly enhanced our statement rendering, check research, and back-room operating productivity. It also improved our customer service capabilities so that customers can now get copies of checks and deposit statements on the spot. We also acquired a new mainframe computer system, which exponentially increased our growth capacity and decreased computer-processing times. Now, instead of taking three hours for the system to process the business day's transactions, it takes less than 30 minutes. As a result, customers have use of the current

day's information sooner. For instance, updated checking account balances for debit card users are transmitted to MasterCard earlier each evening, allowing greater convenience.

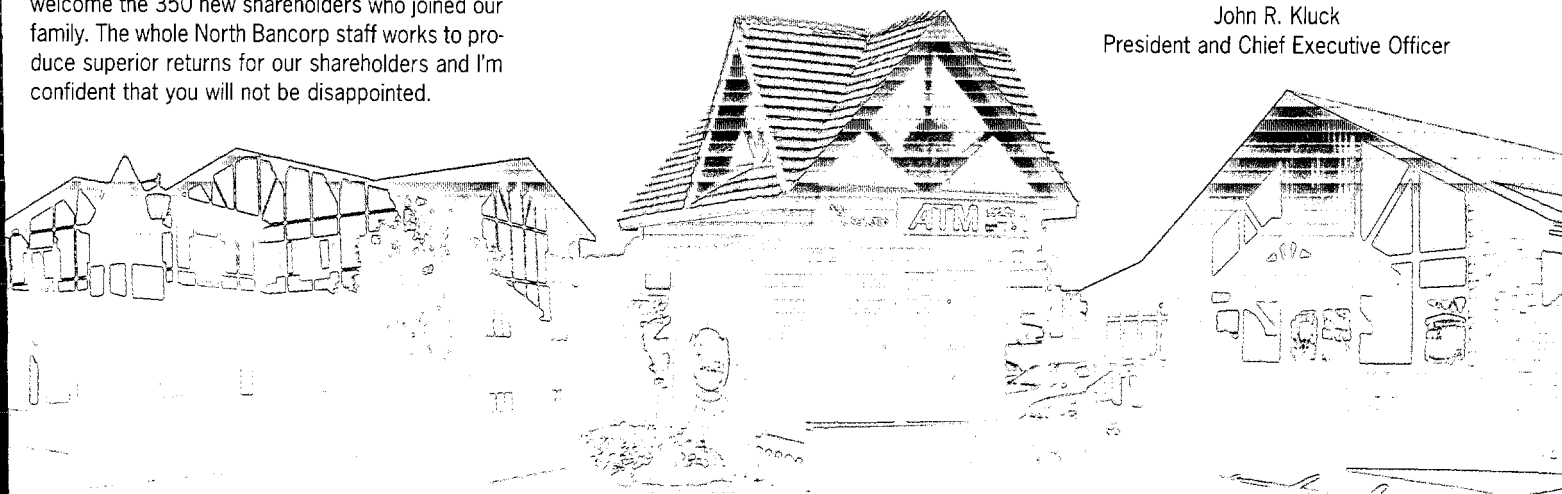
We more than doubled the size of our Aspen Park branch to accommodate increased customer traffic at that location. A full-time lender is now located there, allowing customers a choice of locations when they want to apply for a loan. Whether they apply at our Main Office or the Aspen Park branch, customers can talk face-to-face with the person who has the authority to make a decision. That feature has become scarce with our competitors.

We are excited about the year ahead. We continue to evaluate other markets in northern Michigan and believe that our operating philosophies will attract similar business development opportunities as in Otsego County. The primary test for any expansion initiative is, as always, its contribution to profitability and shareholder value. Our number one strategic goal is to maximize shareholder value consistent with prudent banking practices. As the year progresses, we will keep you informed about our activities.

If there is anything in life that is constant, it is change. Many things changed in our country this past year, some for the better, others not so. We should, however, remember what hasn't changed. Our love of country, our values and our freedom endures. I wish all of you a happy and prosperous year in 2002.

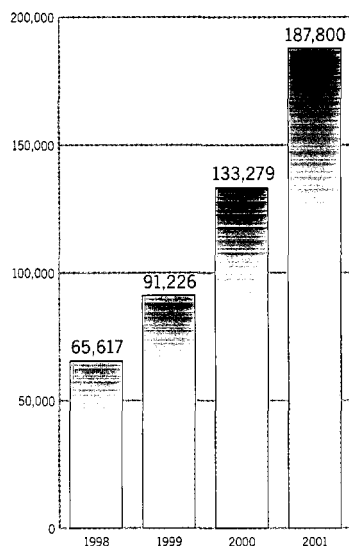
Very truly yours,

John R. Kluck  
President and Chief Executive Officer



## Total Assets

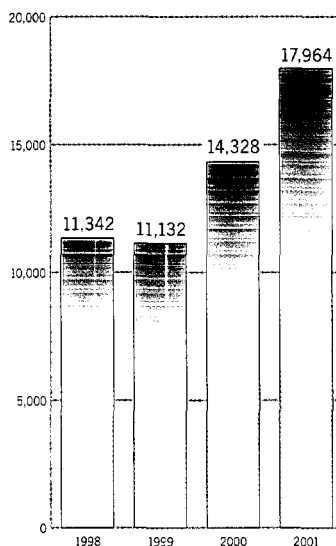
Dollars in thousands



Total assets have increased substantially, as North Bancorp continues to capture market share from competitors.

## Demand Deposits

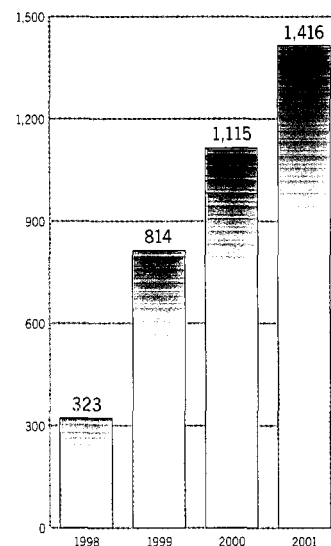
Dollars in thousands



The popularity of North Bancorp's Free Checking products contributed to 27% average growth the last two years.

## Net Income

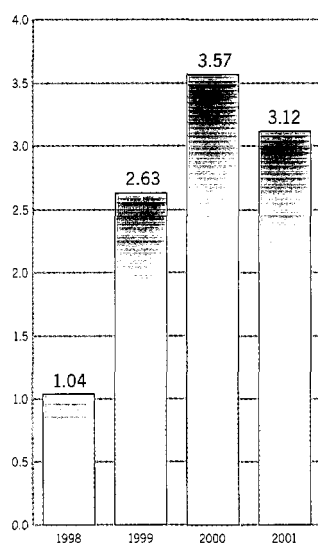
Dollars in thousands



North Bancorp has reported record earnings the last three years through loan growth, asset liability management and operational efficiencies.

## Earnings Per Share

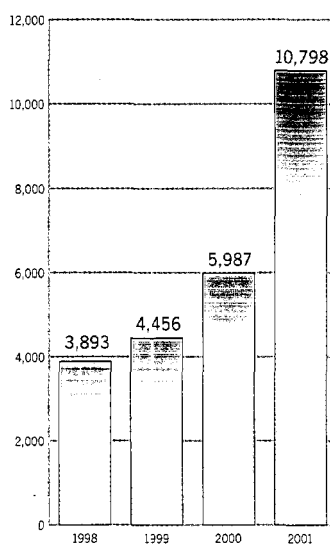
Dollars per share



Earnings per share decreased because the 2001 stock offering increased common shares outstanding 60% compared to 2000.

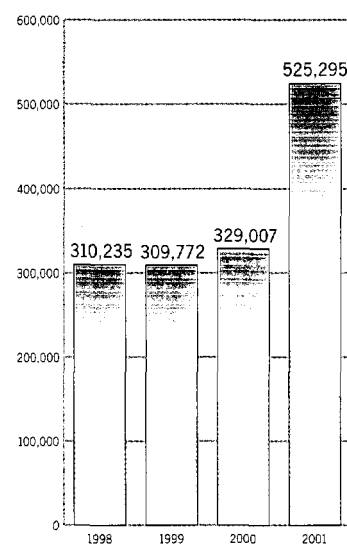
## Stockholders' Equity

Dollars in thousands



Stockholders' equity has increased because of the successful completion of our stock offering in 2001 and record profits in the last three years.

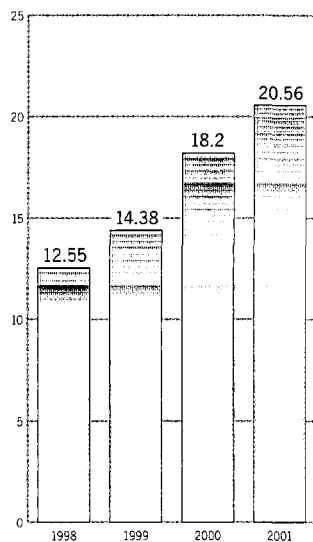
## Common Shares Outstanding



Common shares outstanding increased 60% since 2000 due to the completion of the stock offering in 2001.

### Common Stock Book Value

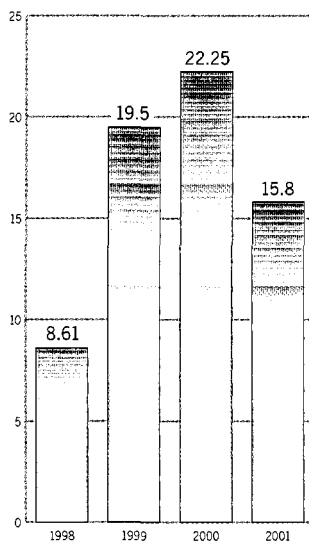
Dollars per share



Despite the increased number of common shares outstanding, book value continues to increase.

### Return on Stockholders' Equity

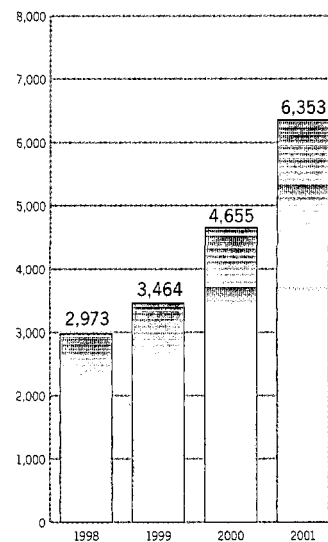
Percent of net income to average stockholders' equity



Return on stockholders' equity has decreased due to the larger base of capital from the 2001 stock offering.

### Net Interest Income

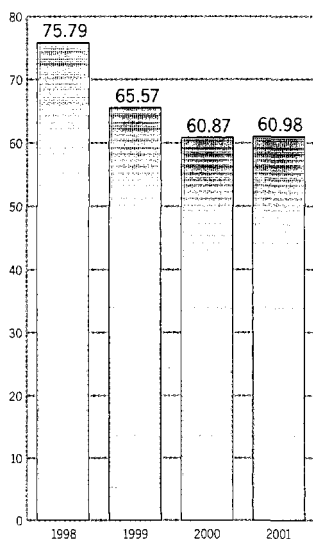
Dollars in thousands



The majority of North Bancorp's growth is in the loan portfolio, which has helped increase net interest income substantially since 1998.

### Efficiency Ratio

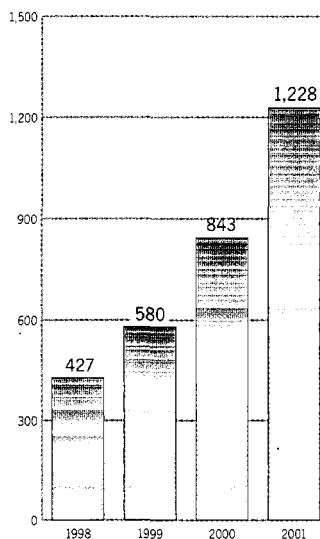
Ratio of operating expenses to net interest income and non-interest income



The efficiency ratio has improved since 1998. In this case, the lower the ratio the more efficient the company is.

### Allowance for Loan Losses

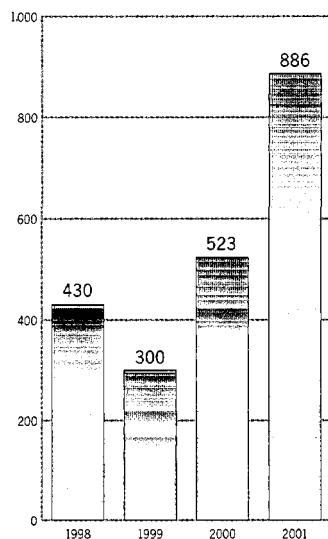
Dollars in thousands



As North Bancorp has grown, significant resources have been devoted to maintaining an appropriate reserve against loan losses.

### Provision for Loan Losses

Dollars in thousands



North Bancorp continues to devote additional resources for loan loss provisions to ensure that the overall reserve for loan losses grows along with the loan portfolio.

# Independent Auditor's Report

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Stockholders and Board of Directors  
North Bancorp, Inc. and Subsidiaries  
Gaylord, Michigan

We have audited the accompanying consolidated balance sheet of North Bancorp, Inc. and Subsidiaries as of December 31, 2001 and 2000 and the related consolidated statements of income, changes in stockholders' equity and cash flows for each year in the three-year period ended December 31, 2001. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting

principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of North Bancorp, Inc. and Subsidiaries as of December 31, 2001 and 2000 and the consolidated results of its operations and its cash flows for each year in the three-year period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States of America.

*Plante & Moran, LLP*

January 23, 2002  
Kalamazoo, MI

# Consolidated Balance Sheet

000s omitted, except per share data.

December 31

	2001	2000
<b>ASSETS</b>		
Cash and cash equivalents		
Cash and due from banks	\$ 5,849	\$ 3,942
Federal funds sold	1,383	-
Total cash and cash equivalents	<u>7,232</u>	<u>3,942</u>
Securities available for sale <small>NOTE 2</small>	16,363	10,426
Securities held to maturity <small>NOTE 2</small>	1,042	2,952
Other securities <small>NOTE 2</small>	2,334	2,024
Loans <small>NOTE 3</small>	157,106	111,036
Less allowance for loan losses <small>NOTE 4</small>	<u>1,228</u>	<u>843</u>
Net loans	155,878	110,193
Bank premises and equipment - Net <small>NOTE 6</small>	2,374	1,794
Accrued interest receivable	1,179	1,011
Other assets	<u>1,398</u>	<u>937</u>
<b>TOTAL ASSETS</b>	<b><u>\$ 187,800</u></b>	<b><u>\$ 133,279</u></b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Liabilities</b>		
Deposits:		
Noninterest-bearing	\$ 17,964	\$ 14,328
Interest-bearing <small>NOTE 7</small>	<u>118,654</u>	<u>71,324</u>
Total deposits	136,618	85,652
Short-term borrowings <small>NOTE 8</small>	2,139	6,449
Notes payable <small>NOTE 9</small>	37,132	33,803
Accrued interest payable	371	341
Other liabilities	<u>742</u>	<u>1,047</u>
<b>TOTAL LIABILITIES</b>	<b><u>\$ 177,002</u></b>	<b><u>\$ 127,292</u></b>
<b>Stockholders' Equity</b>		
Common stock, \$1 par value:		
Authorized - 3,000,000 at December 31, 2001		
and 500,000 at December 31, 2000		
Issued and outstanding - 525,295 at		
December 31, 2001 and 329,007 at		
December 31, 2000	525	329
Additional paid-in capital	5,996	2,675
Retained earnings	4,150	2,926
Accumulated other comprehensive income	<u>127</u>	<u>57</u>
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<b>10,798</b>	<b>5,987</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b><u>\$ 187,800</u></b>	<b><u>\$ 133,279</u></b>

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.



# Consolidated Statement of Income

000s omitted, except per share data.

For the year ended December 31

	2001	2000	1999
<b>INTEREST INCOME</b>			
Interest and fees on loans	\$ 12,590	\$ 8,889	\$ 5,110
Investment securities:			
Taxable	814	740	683
Tax-exempt	99	75	47
Federal funds sold	18	8	31
<b>TOTAL INTEREST INCOME</b>	<b>13,521</b>	<b>9,712</b>	<b>5,871</b>
<b>INTEREST EXPENSE</b>			
Deposits	4,722	3,121	2,006
Borrowings	2,446	1,936	401
<b>TOTAL INTEREST EXPENSE</b>	<b>7,168</b>	<b>5,057</b>	<b>2,407</b>
Net Interest Income	6,353	4,655	3,464
Provision for Loan Losses <b>NOTE 4</b>	886	523	300
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>5,467</b>	<b>4,132</b>	<b>3,164</b>
<b>OTHER INCOME</b>			
Service charges on deposit accounts	447	450	411
Loan servicing fee	54	39	38
Gain on sale of real estate mortgages originated for sale	517	105	88
Gain on sale of available for sale securities	36	-	19
Other income	278	302	252
<b>TOTAL OTHER INCOME</b>	<b>1,332</b>	<b>896</b>	<b>808</b>
<b>OTHER EXPENSES</b>			
Salaries, wages and benefits <b>NOTES 12, 13 &amp; 14</b>	2,197	1,711	1,345
Occupancy expense	185	179	161
Equipment and data processing expense	412	311	291
Advertising and public relations	136	108	60
Professional fees	260	96	153
Office supplies and postage	206	131	125
Other expenses	1,290	843	666
<b>TOTAL OTHER EXPENSES</b>	<b>4,686</b>	<b>3,379</b>	<b>2,801</b>
Income - Before income taxes	2,113	1,649	1,171
Federal Income Tax Expense <b>NOTE 10</b>	697	534	357
<b>NET INCOME</b>	<b>\$ 1,416</b>	<b>\$ 1,115</b>	<b>\$ 814</b>
<b>BASIC EARNINGS PER SHARE</b>	<b>\$ 3.12</b>	<b>\$ 3.57</b>	<b>\$ 2.63</b>

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

# Consolidated Statement of Changes in Stockholders' Equity

000s omitted, except per share data.

	Number of Shares	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
<b>Balance - January 1, 1999</b>	<b>124,094</b>	<b>\$ 124</b>	<b>\$ 2,349</b>	<b>\$ 1,389</b>	<b>\$ 31</b>	<b>\$ 3,893</b>
Net income				814		814
Change in net unrealized gain on securities available for sale, net of tax					(154)	(154)
<b>TOTAL COMPREHENSIVE INCOME</b>						<b>660</b>
Cash dividend (\$0.30 per share) (1)				(93)		(93)
Stock redemption	(103)			(4)		(4)
<b>Balance - December 31, 1999</b>	<b>123,991</b>	<b>124</b>	<b>2,349</b>	<b>2,106</b>	<b>(123)</b>	<b>4,456</b>
Net income				1,115		1,115
Change in net unrealized gain on securities available for sale, net of tax					180	180
<b>TOTAL COMPREHENSIVE INCOME</b>						<b>1,295</b>
Cash dividend (\$0.33 per share) (1)				(103)		(103)
5-for-4 stock split declared March 24, 2000	30,998	31		(31)		(0)
Stock redemption of fractional shares	(154)			(6)		(6)
2-for-1 stock split declared June 23, 2000	154,835	155		(155)		
Issuance of common stock, net of offering expenses of \$42	19,337	19	326			345
<b>Balance - December 31, 2000</b>	<b>329,007</b>	<b>329</b>	<b>2,675</b>	<b>2,926</b>	<b>57</b>	<b>5,987</b>
Net income				1,416		1,416
Change in net unrealized gain on securities available for sale, net of tax					70	70
<b>TOTAL COMPREHENSIVE INCOME</b>						<b>1,486</b>
Cash dividend (\$0.40 per share)				(192)		(192)
Issuance of common stock, net of offering expenses of \$409	196,288	196	3,321			3,517
<b>Balance - December 31, 2001</b>	<b>525,295</b>	<b>\$ 525</b>	<b>\$ 5,996</b>	<b>\$ 4,150</b>	<b>\$ 127</b>	<b>\$ 10,798</b>

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) Adjusted for the 5-for-4 stock split declared March 24, 2000 and the 2-for-1 stock split declared June 23, 2000.

# Consolidated Statement of Cash Flows

000s omitted.  
For year ended December 31

	2001	2000	1999
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net income	\$ 1,416	\$ 1,115	\$ 814
Adjustments to reconcile net income to net cash from operating activities:			
Depreciation	237	178	178
Provision for loan losses	886	523	300
Deferred federal income taxes	22	3	6
Amortization and (accretion) of securities - Net	55	40	90
Gain on sale of securities available for sale	(37)	-	(19)
Gain (loss) on sale of premises and equipment	19	(1)	(4)
Accrued interest receivable and other assets	(651)	(577)	(278)
Accrued interest payable and other liabilities	(311)	(22)	372
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>1,636</b>	<b>1,259</b>	<b>1,459</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Purchases of securities available for sale	(14,888)	(1,696)	(5,600)
Proceeds from maturities of securities available for sale	6,376	818	1,360
Proceeds from sale of securities available for sale	2,667	-	4,290
Purchases of securities held to maturity	(300)	(1,300)	(350)
Proceeds from maturities of securities held to maturity	2,206	742	765
Purchases of other securities	(310)	(875)	(770)
Net increase in loans	(46,571)	(39,125)	(26,897)
Purchases of premises and equipment	(883)	(485)	(47)
Proceeds from sale of premises and equipment	47	1	11
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(51,656)</b>	<b>(41,920)</b>	<b>(27,238)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Net increase in deposits	50,966	21,513	3,610
Net change in short-term borrowings	(4,310)	1,549	3,525
Proceeds from notes payable	16,961	27,012	20,586
Repayment of notes payable	(13,632)	(9,864)	(3,047)
Dividends paid to stockholders	(192)	(103)	(93)
Stock redemption	-	(6)	(4)
Proceeds from issuance of common stock, net of offering expenses	3,517	345	-
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>	<b>53,310</b>	<b>40,446</b>	<b>24,577</b>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>3,290</b>	<b>(215)</b>	<b>(1,202)</b>
<b>Cash and Cash Equivalents - Beginning of year</b>	<b>3,942</b>	<b>4,157</b>	<b>5,359</b>
<b>Cash and Cash Equivalents - End of year</b>	<b>\$ 7,232</b>	<b>\$ 3,942</b>	<b>\$ 4,157</b>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b>			
Cash paid during the year:			
Interest	\$ 7,138	\$ 4,891	\$ 2,497
Federal Income Taxes	\$ 750	\$ 715	\$ (34)

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

# Notes to Consolidated Financial Statements

December 31, 2001 and 2000.

## Note 1 – Summary of Significant Accounting Policies

### *Basis of Presentation and Consolidation –*

The consolidated financial statements include the accounts of North Bancorp, Inc. and its wholly-owned subsidiaries, First National Bank of Gaylord (Bank), and First of Gaylord Financial Services, Inc., collectively referred to as the "Corporation". All significant inter-company transactions and accounts have been eliminated in consolidation.

*Use of Estimates –* The accounting and reporting policies of the Corporation and its subsidiaries conform to generally accepted accounting principles. Management is required to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates and assumptions. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and deferred tax assets.

*Nature of Operations –* First National Bank of Gaylord is engaged in the business of commercial and retail banking. The Bank offers a variety of deposit products, including checking accounts, savings accounts, time deposits, and short-term deposits. The Bank conducts lending activities in the residential and commercial mortgage markets, in the general commercial market and in the consumer installment marketplace. Substantially all loans are secured by business or personal assets. These financial services and products are delivered through its main office and one branch office located in Gaylord, Michigan in Otsego County.

First of Gaylord Financial Services, Inc. is an investment held to provide insurance services for the Bank.

*Significant Group Concentrations of Credit Risk –* Most of the Corporation's activities are with customers located within

Michigan. Note 2 discusses the types of securities the Corporation invests in. Note 3 discusses the types of lending that the Corporation engages in. The Corporation does not have any significant concentrations to any one industry or customer.

*Cash and Cash Equivalents –* For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks and federal funds sold. Generally, federal funds are purchased and sold for a one-day period.

*Securities –* Debt securities that management has the positive intent and ability to hold to maturity are classified as "held to maturity" and recorded at amortized cost. Securities not classified as held to maturity, including equity securities with readily determinable fair values, are classified as "available for sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

*Loans –* The Corporation grants mortgage, commercial and consumer loans to customers. Loans are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the straight-line method.

The accrual of interest on loans is discontinued at the time the loan is 90 days delinquent unless the credit is well-secured and in process of collection. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

*Allowance for Loan Losses –* The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in

# Notes to Consolidated Financial Statements

December 31, 2001 and 2000.

determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of homogeneous loans are collectively evaluated for impairment. Accordingly, the Corporation does not separately identify individual consumer and residential loans for impairment disclosures.

**Servicing** – Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. Capitalized servicing rights are reported in other assets and are amortized into other expense in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates and terms. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Impairment is recognized through a valuation allowance for an individual stratum, to the

extent that fair value is less than the capitalized amount for the stratum.

**Credit Related Financial Instruments** – In the ordinary course of business, the Corporation has entered into commitments to extend credit, including commitments under commercial letters of credit and standby letters of credit. Such financial instruments are recorded when they are funded.

**Premises and Equipment** – Land is carried at cost. Bank premises and equipment are stated at cost, less accumulated depreciation. Depreciation, computed on the straight-line method, is charged to operations over the estimated useful lives of the assets.

**Income Taxes** – Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the various temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

**Postretirement Benefits** – Postretirement benefits are recognized in the financial state-

ments as earned over the employee's active service period.

**Earnings Per Share** – Earnings per share are based on the weighted average number of shares outstanding during each period. The calculated earnings per share and weighted average number of shares have been retroactively adjusted to consider the impact of the stock splits. Weighted average number of shares outstanding totaled 454,486, 312,157, and 309,670 for the years ended December 31, 2001, 2000, and 1999, respectively. The Corporation does not have any dilutive stock plans; therefore, basic and dilutive earnings per share are the same.

**Comprehensive Income** – Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

**Reclassification** – Certain prior year amounts have been reclassified to conform with current year presentation.

The components of other comprehensive income and related tax effects are as follows (000s omitted):

	2001	2000	1999
Unrealized holding gains (losses) on available-for-sale securities	\$ 142	\$ 273	\$ (214)
Reclassification adjustment for gains realized in income	36	-	19
Net unrealized gains (losses)	106	273	(233)
Tax effect	36	93	(79)
Net-of-tax amount	\$ 70	\$ 180	\$ (154)

# Notes to Consolidated Financial Statements

December 31, 2001 and 2000.

## Note 2 – Securities

The amortized cost and estimated fair market values of securities are as follows at December 31, 2001 and 2000 (000s omitted):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>2001</b>				
<b>Available-for-sale securities:</b>				
U.S. treasury notes	\$ 5,266	\$ 106	\$ 5	\$ 5,367
Obligations of other U.S. government agencies	3,721	64	–	3,785
Obligations of states and political subdivisions	3,918	21	5	3,934
Mortgage-backed securities	1,652	12	6	1,658
Corporate	1,613	10	4	1,619
<b>Total available-for-sale securities</b>	<b>\$ 16,170</b>	<b>\$ 213</b>	<b>\$ 20</b>	<b>\$ 16,363</b>
<b>Held-to-maturity securities:</b>				
Obligations of states and political subdivisions	\$ 1,042	\$ 15	\$ 1	\$ 1,056
<b>2000</b>				
<b>Available-for-sale securities:</b>				
U.S. treasury notes	\$ 4,202	\$ 38	\$ 1	\$ 4,239
Obligations of other U.S. government agencies	4,297	70	6	4,361
Obligations of states and political subdivisions	1,042	–	5	1,037
Mortgage-backed securities	799	–	10	789
<b>Total available-for-sale securities</b>	<b>\$ 10,340</b>	<b>\$ 108</b>	<b>\$ 22</b>	<b>\$ 10,426</b>
<b>Held-to-maturity securities:</b>				
Obligations of other U.S. government agencies	\$ 906	\$ 29	\$ 2	\$ 933
Obligations of states and political subdivisions	2,046	8	–	2,054
<b>Total held-to-maturity securities</b>	<b>\$ 2,952</b>	<b>\$ 37</b>	<b>\$ 2</b>	<b>\$ 2,987</b>

The amortized cost and estimated market values of securities at December 31, 2001, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties (000s omitted).

	<b>Available for Sale</b>		<b>Held to Maturity</b>	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$ 3,007	\$ 3,041	\$ 445	\$ 450
Due after one year through five years	10,201	10,359	597	606
Due after five years through ten years	1,310	1,305	–	–
<b>Total</b>	<b>14,518</b>	<b>14,705</b>	<b>1,042</b>	<b>1,056</b>
Mortgage-backed securities	1,652	1,658	–	–
<b>Total</b>	<b>\$ 16,170</b>	<b>\$ 16,363</b>	<b>\$ 1,042</b>	<b>\$ 1,056</b>

# Notes to Consolidated Financial Statements

December 31, 2001 and 2000.

## Note 2 - Securities (Continued)

Securities with a carrying value of \$6,887,000 (market value of \$7,024,000) were pledged at December 31, 2001 to secure borrowings from the Federal Home Loan Bank.

Other securities consist of restricted Federal Home Loan Bank of Indianapolis and Federal Reserve Bank of Chicago stock. These securities are carried at cost, which approximates market.

Following is a summary of available for sale security sales for the years ended December 31, 2001, 2000, and 1999 (000s omitted):

	2001	2000	1999
Gross proceeds	\$ 2,667	-	\$ 4,290
Gross gains	36	-	21
Gross losses	-	-	2
Applicable income tax provision	12	-	6

## Note 3 - Loans

Certain directors and executive officers of the Corporation, including their associates, were loan customers of the subsidiary bank during 2001 and 2000. Management believes such loans were made in the ordinary course of business and do not involve more than a normal risk of collectibility. The outstanding loan balances for these individuals at December 31, 2001 and 2000 amounted to \$1,482,000 and \$945,000, respectively. During 2001, \$1,214,000 of new loans were made and repayment totaled \$677,000. The total unused commitments for these loans were \$361,000 at December 31, 2001.

Major categories of loans in the portfolio are as follows at December 31, 2001 and 2000 (000s omitted):

	2001	2000
Mortgage loans on real estate:		
Residential 1-4 family	\$ 54,694	\$ 33,601
Construction	12,434	5,244
Second mortgages	4,166	6,050
Equity lines of credit	1,505	1,339
Commercial	26,193	20,264
Commercial loans	17,936	10,585
Consumer installment loans:		
Personal	39,823	33,634
Personal lines of credit	355	319
<b>Total</b>	<b>\$ 157,106</b>	<b>\$ 111,036</b>

## Note 4 - Allowance for Loan Losses

Changes in the allowance for loan losses were as follows (000s omitted):

	2001	2000	1999
<b>Balance - Beginning of year</b>	<b>\$ 843</b>	<b>\$ 580</b>	<b>\$ 427</b>
Provision charged to operations	886	523	300
Loans charged off	(601)	(332)	(216)
Recoveries of loans charged off	100	72	69
<b>Balance - End of year</b>	<b>\$ 1,228</b>	<b>\$ 843</b>	<b>\$ 580</b>

# Notes to Consolidated Financial Statements

December 31, 2001 and 2000.

## Note 4 – Allowance for Loan Losses (Continued)

Impaired loans consist of the following (000s omitted):

	2001	2000	1999
<u>As of December 31:</u>			
Recorded investment in impaired loans for which there is a related allowance for loan losses	\$ 442	\$ 39	\$ –
Recorded investment in impaired loans for which there is no related allowance for loan losses	95	18	15
Recorded investment in impaired loans	\$ 537	\$ 57	\$ 15
<u>For the year ended December 31:</u>			
Average recorded investment in impaired loans during the year	\$ 132	\$ 68	\$ 64
Interest income recognized during the time the loans were impaired	\$ –	\$ –	\$ –
Interest income recognized using a cash-basis method of accounting during the time the loans were impaired	\$ –	\$ –	\$ –

## Note 5 – Mortgage Loan Servicing

Mortgage loans serviced for the Federal Home Loan Mortgage Corporation are not included in the accompanying consolidated balance sheet. The unpaid principal balances of loans serviced for others were \$40,035,000 and \$19,262,000 at December 31, 2001 and 2000, respectively.

The balance of mortgage servicing rights included in other assets at December 31, 2001 and 2000 was \$393,000 and \$160,000, respectively. Included in the gain on sale of real estate mortgages originated for sale, are mortgage servicing rights capitalized of \$388,000, \$78,000, and

\$71,000 for the years ended December 31, 2001, 2000, and 1999, respectively. Included in other expenses is amortization of mortgage servicing rights of \$155,000, \$42,000, and \$37,000 for the years ended December 31, 2001, 2000, and 1999, respectively.

## Note 6 – Bank Premises and Equipment

Major classifications of bank premises and equipment are summarized as follows at December 31, 2001 and 2000 (000s omitted):

	2001	2000	Estimated Lives
Land	\$ 440	\$ 440	
Land improvements	323	312	10 - 40 years
Building and building improvements	1,194	1,154	5 - 40 years
Furniture and equipment	1,604	1,236	3 - 20 years
<b>Total</b>	<b>3,561</b>	<b>3,142</b>	
Less accumulated depreciation	(1,552)	(1,348)	
Net	2,009	1,794	
Construction in process	365	–	
<b>Total</b>	<b>\$ 2,374</b>	<b>\$ 1,794</b>	



# Notes to Consolidated Financial Statements

December 31, 2001 and 2000.

## Note 7 – Deposits

The following is a summary of interest-bearing deposits at December 31, 2001 and 2000 (000s omitted):

	2001	2000
NOW accounts	\$ 14,029	\$ 5,716
Savings	18,773	15,017
Certificates of deposit:		
\$100,000 and over	26,714	11,098
Under \$100,000	59,138	39,492
<b>Total interest-bearing deposits</b>	<b>\$ 118,654</b>	<b>\$ 71,323</b>

At December 31, 2001, the scheduled maturities of time deposits are as follows (000s omitted):

2002	\$ 49,208
2003	20,634
2004	11,341
2005	1,938
2006	2,731
<b>Total</b>	<b>\$ 85,852</b>

## Note 8 – Short-term Borrowings

The Corporation has a \$4,000,000 line of credit available from a bank. This line of credit was restricted for use as a capital investment in First National Bank of Gaylord. Interest is calculated at the bank's prime rate less .50 percent, and is paid monthly. Principal is due at maturity in July 2002. The note is collateralized by 100 percent of the stock of First National Bank of Gaylord. The Corporation had outstanding borrowings under this agreement of \$2,139,000 and

\$3,050,000 at December 31, 2001 and 2000, respectively.

The Corporation has a \$5,000,000 line of credit for short-term borrowings available from the Federal Home Loan Bank of Indianapolis (FHLB). This line is used as a source of short-term liquidity. The interest is computed using a variable interest rate (1.82 percent and 6.30 percent at December 31, 2001 and 2000, respectively) established by

the FHLB. The Corporation had outstanding borrowings under this agreement of \$0 and \$3,399,000 at December 31, 2001 and 2000, respectively. The Corporation has a blanket collateral agreement with FHLB covering certain investment securities and certain qualifying residential mortgage loans owned by the Corporation. The line of credit agreement expires March 1, 2002.

## Note 9 – Notes Payable

The Corporation has various term advances from the FHLB with fixed interest rates ranging from 3.67 percent to 7.56 percent at December 31, 2001, and 5.47 percent to 7.56 percent at December 31, 2000. Maturity dates range from January 2002 to December 2006. Total borrowings under these advances are \$37,132,000 and \$33,803,000 at December 31, 2001 and 2000, respectively. Interest on these borrowings is payable monthly. The Corporation has a blanket collateral agreement with FHLB covering certain unpledged securities and certain qualifying residential mortgage loans owned by the Corporation.

Maturities of notes payable are as follows as of December 31, 2001 and 2000 (000s omitted):

	2001	2000
2001	\$ –	\$ 12,761
2002	14,461	10,964
2003	8,885	5,557
2004	4,875	3,021
2005	5,411	1,500
2006	3,500	–
<b>Total</b>	<b>\$ 37,132</b>	<b>\$ 33,803</b>

# Notes to Consolidated Financial Statements

December 31, 2001 and 2000.

## Note 10 – Income Taxes

The Corporation and its subsidiaries file a consolidated federal income tax return. The following is a summary of the provision for income taxes for the years ended December 31, 2001, 2000, and 1999 (000s omitted):

	2001	2000	1999
Current expense	\$ 675	\$ 532	\$ 351
Deferred expense	22	2	6
<b>Total income tax expense</b>	<b>\$ 697</b>	<b>\$ 534</b>	<b>\$ 357</b>

The following is a reconciliation of the statutory federal income tax rate to the Corporation's effective tax rate:

	Percent of Pretax Income		
	Years Ended December 31		
	2001	2000	1999
Income tax at statutory rate	34 %	34 %	34 %
Tax-exempt interest	(2 %)	(2 %)	–
Other	1 %	–	(3 %)
<b>Actual effective tax rate</b>	<b>33 %</b>	<b>32 %</b>	<b>31 %</b>

The significant components of the Corporation's deferred tax assets and liabilities at December 31, 2001 and 2000 are as follows (000s omitted):

	2001	2000
Deferred tax assets:		
Accrued postretirement benefit cost	\$ 55	\$ 38
Allowance for loan losses	246	172
Deferred compensation	45	36
Other	1	1
<b>Total deferred tax assets</b>	<b>347</b>	<b>247</b>
Deferred tax liabilities:		
Fixed assets	(104)	(96)
Mortgage servicing rights	(133)	(54)
Net loan fees	(142)	(100)
Other	–	(7)
Unrealized gain on securities available for sale	(66)	(28)
<b>Total deferred tax liabilities</b>	<b>(445)</b>	<b>(285)</b>
<b>Net deferred tax liability</b>	<b>\$ (98)</b>	<b>\$ (38)</b>

# Notes to Consolidated Financial Statements

December 31, 2001 and 2000.

## Note 11 - Off-Balance Sheet Activities

**Credit-Related Financial Instruments -**  
The Corporation is a party to credit related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing need of its customers. These financial instruments include commitments to extend credit, standby letters of credit and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

The Corporation's exposure to credit loss is represented by the contractual amount of these commitments. The Corporation follows the same credit policies in making commitments as it does for on-balance-sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments for equity lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Corporation, is based on management's credit evaluation of the customer.

Unfunded commitments under commercial lines of credit and revolving credit lines are commitments for possible future extensions of credit to existing customers. These lines of credit are collateralized and usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Corporation is committed.

Commercial and standby letters of credit are conditional commitments issued by the

At December 31, 2001, and 2000, the following financial instruments were outstanding whose contract amounts represent credit risk (000s omitted):

	Contract Amount	
	2001	2000
Commitments to grant loans	\$ 10,944	\$ 5,629
Unfunded commitments under lines of credit	2,044	1,160
Commercial and standby letters of credit	190	210

Corporation to guarantee the performance of a customer to a third party. Those letters of credit are primarily used to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year. The Corporation generally holds collateral supporting those commitments if deemed necessary.

## Note 12 - Retirement Plan

The Corporation has a 401(k) plan that is a defined contribution savings plan for employees. Employer contributions are discretionary and are determined by the Board of Directors. The Corporation matches 100 percent of the participant's first two percent of compensation contributed and 50 percent of the next three percent of compensation contributed. For the years ended December 31, 2001, 2000 and 1999, the expense attributable to this plan was \$30,000, \$18,000 and \$24,000, respectively.

## Note 13 - Deferred Compensation Plan

The Corporation has a nonqualified deferred compensation plan with a certain officer, whereby the officer or designated beneficiary will receive approximately \$50,000 per year for fifteen years in the event of retirement, disability, or death. The present value of the future benefits will be accrued to the full eligibility date of the officer. The accrued deferred compensation benefit cost at December 31, 2001 and 2000 corresponding to this plan was

\$132,000 and \$106,000, respectively. Expense in the amount of \$26,000, \$43,000 and \$27,000 has been charged to operations for the years ended December 31, 2001, 2000 and 1999, respectively.

To fund this obligation, the Corporation has purchased insurance on the life of the participating officer with the Corporation as the owner and beneficiary of the policy. The cash surrender value of the life insurance contract totaled \$446,000 and \$348,000 at December 31, 2001 and 2000, respectively. Income in the amount of \$18,000, \$12,000, and \$9,000 has been earned and recorded for the years ended December 31, 2001, 2000, and 1999 respectively.

## Note 14 - Postretirement Health Care Plan

The Corporation sponsors a defined benefit postretirement plan that provides postretirement health care benefits to certain retired directors, current directors, and their spouses. The plan is currently not funded. The expected cost of providing these types of benefits is accrued over the years in which participants' services are provided to the Corporation.

The accumulated obligation for employee post-retirement benefits attributable to active and retired employees was \$163,000 and \$116,000 at December 31, 2001 and 2000, respectively. Expenses for these benefits were \$86,000, \$41,000 and \$37,000 for 2001, 2000 and 1999, respectively.

# Notes to Consolidated Financial Statements

December 31, 2001 and 2000.

## Note 15 – Fair Values of Financial Instruments

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Corporation's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. SFAS 107 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Corporation.

The following methods and assumptions were used by the Corporation in estimating fair value disclosures for financial instruments:

**Cash and Cash Equivalents** – The carrying amounts of cash and short-term instruments approximate fair values.

**Securities** – Fair values for securities, excluding Federal Home Loan Bank of Indianapolis stock and Federal Reserve Bank of Chicago stock, are based on quoted market prices. The carrying value of Federal Home Loan Bank of Indianapolis stock and Federal Reserve Bank of Chicago stock approximate fair value based on the redemption provisions of the Federal Home Loan Bank of Indianapolis and the Federal Reserve Bank of Chicago.

**Loans Receivable** – For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for certain mortgage loans (e.g., one-to-four family residential), credit card loans, and other consumer loans are based on quoted market prices of similar loans sold in conjunction with securitization transactions, adjusted for differences in loan characteristics.

Fair values for other loans (e.g., commercial real estate and investment property mortgage loans, commercial and industrial loans) are estimated using discounted cash flow analysis, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for non-performing loans are estimated using discounted cash flow analysis or underlying collateral values, where applicable.

**Deposit Liabilities** – The fair values disclosed for demand deposits (e.g., interest and non-interest checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). The carrying amounts of variable rate, fixed term money market accounts and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

**Short-term Borrowings** – Fair values of the Corporation's short-term borrowings are estimated using discounted cash flow analysis based on the Corporation's current incremental borrowing rates for similar types of borrowing arrangements.

**Notes Payable** – The fair values of the Corporation's notes payable are estimated using discounted cash flow analysis based on the Corporation's current incremental borrowing rates for similar types of borrowing arrangements.

The estimated fair values, and related carrying or notional amounts, of the Corporation's financial instruments at December 31, 2001 and 2000 are as follows (000s omitted):

### Financial Assets:

	2001		2000	
	Carrying Amounts	Estimated Fair Value	Carrying Amounts	Estimated Fair Value
Cash and cash equivalents	\$ 7,232	\$ 7,232	\$ 3,942	\$ 3,942
Securities available for sale	16,363	16,363	10,426	10,426
Securities held to maturity	1,042	1,056	2,952	2,987
Other securities	2,334	2,334	2,024	2,024
Loans - net	155,878	168,123	110,193	106,978
Accrued interest receivable	1,179	1,179	1,011	1,011

### Financial Liabilities:

Customer deposits	136,618	138,336	85,652	85,516
Accrued interest payable	371	371	341	341
Short-term borrowings	2,139	2,139	6,449	6,449
Notes payable	37,132	39,113	33,803	33,019

# Notes to Consolidated Financial Statements

December 31, 2001 and 2000.

## Note 15 – Fair Values of Financial Instruments (Continued)

**Accrued Interest** – The carrying amounts of accrued interest approximate fair value.

**Off-Balance Sheet Instruments** – Fair values for off-balance sheet, credit related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. Fair values for off-balance sheet derivative financial instruments, for other than trading purposes, are based upon quoted market prices, except in the case of certain options and swaps where pricing models are used.

## Note 16 – Regulatory Matters

The Corporation (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to

meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Corporation's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Corporation and the Bank to maintain minimum amounts, and ratios (set forth in the following table) of total and Tier

1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2001 and 2000, that the Corporation and the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2001, the most recent notification from the Office of the Comptroller of the Currency categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notification that management believes have changed the Bank's category. The Corporation's and the Bank's actual capital amounts and ratios as of December 31, 2001 and 2000 are also presented in the table (000s omitted).

	Actual		Minimum Required for Capital Adequacy Purposes		Minimum Required to be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>As of December 31, 2001:</b>						
Total Capital (to Risk Weighted Assets)						
Consolidated	\$ 11,860	8.98 %	\$ 10,566	8.00 %	n/a	n/a
First National Bank of Gaylord	13,974	10.59 %	10,556	8.00 %	\$ 13,195	10.00 %
Tier 1 Capital (to Risk Weighted Assets)						
Consolidated	\$ 10,632	8.05 %	\$ 5,283	4.00 %	n/a	n/a
First National Bank of Gaylord	12,796	9.66 %	5,299	4.00 %	\$ 7,948	6.00 %
Tier 1 Capital (to Average Assets)						
Consolidated	\$ 10,632	6.01 %	\$ 7,076	4.00 %	n/a	n/a
First National Bank of Gaylord	12,746	7.20 %	7,081	4.00 %	\$ 8,851	5.00 %

# Notes to Consolidated Financial Statements

December 31, 2001 and 2000.

## Note 16 – Regulatory Matters (Continued)

### As of December 31, 2000:

Total Capital

(to Risk Weighted Assets)

Consolidated

First National Bank of Gaylord

Actual	
Amount	Ratio

### Minimum Required for Capital Adequacy Purposes

Amount	Ratio
--------	-------

### Minimum Required to be Well Capitalized Under Prompt Corrective Action Provisions

Amount	Ratio
--------	-------

	\$ 6,729	7.34 %	\$ 7,339	8.00 %	n/a	n/a
	9,623	10.49 %	7,339	8.00 %	\$ 9,172	10.00 %
Tier 1 Capital (to Risk Weighted Assets)						
Consolidated	\$ 5,886	6.42 %	\$ 3,670	4.00 %	n/a	n/a
First National Bank of Gaylord	8,780	9.57 %	3,670	4.00 %	\$ 5,503	6.00 %
Tier 1 Capital (to Average Assets)						
Consolidated	\$ 5,886	5.28 %	\$ 4,463	4.00 %	n/a	n/a
First National Bank of Gaylord	8,780	7.87 %	4,463	4.00 %	\$ 5,576	5.00 %

## Note 17 – Restrictions On Dividends, Loans And Advances

Federal banking regulations place certain restrictions on dividends paid and loans or advances made by the Bank to the Corporation.

Prior approval of the Bank's federal regulator is required if the total dividends declared by the Bank in a calendar year exceed the sum of the net profits of the Bank for the preceding three years, less any required transfers to surplus. In addition, dividends paid by the Bank would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum standards. At December 31, 2001, the Bank's retained earnings available for the payment of dividends was \$2,801,000. Accordingly, \$10,111,000 of the Corporation's investment in the Bank was restricted at December 31, 2001.

Loans or advances made by the Bank to the Corporation are generally limited to 10 percent of the Bank's capital stock and surplus. Accordingly, at December 31, 2001, Bank funds available for loans or advances by the Bank to the Corporation amounted to \$430,000.

## Note 18 – Parent-only Financial Statements

The following represents the condensed financial statements of North Bancorp, Inc. ("Parent") only. The Parent-only financial information should be read in conjunction with the Corporation's consolidated financial statements.

The condensed balance sheet at December 31, 2001 and 2000 is as follows (000s omitted):  
(Table applies to Note 18)

	2001	2000
Assets		
Cash at subsidiary bank	\$ 90	\$ 159
Investment in subsidiary	12,912	8,881
Other	4	79
<b>Total assets</b>	<b>\$ 13,006</b>	<b>\$ 9,119</b>
Liabilities and Stockholders' Equity		
Short-term borrowings	\$ 2,139	\$ 3,050
Other	69	82
Stockholders' Equity	10,798	5,987
<b>Total liabilities and stockholders' equity</b>	<b>\$ 13,006</b>	<b>\$ 9,119</b>

# Notes to Consolidated Financial Statements

December 31, 2001 and 2000.

## Note 18 - Parent-only Financial Statements (Continued)

The condensed statement of operations for the years ended December 31, 2001, 2000, and 1999 is as follows (000s omitted):

	2001	2000	1999
Dividends from subsidiary	\$ 510	\$ 342	\$ 225
Operating expense	305	199	29
Income - Before income taxes and equity in undistributed net income of subsidiary	205	143	196
Income tax expense	-	-	-
Income - Before equity in undistributed net income of subsidiary	205	143	196
Equity in income of subsidiary	1,211	972	618
<b>Net income</b>	<b>\$ 1,416</b>	<b>\$ 1,115</b>	<b>\$ 814</b>

The condensed statement of cash flows for the years ended December 31, 2001, 2000, and 1999 is as follows (000s omitted):

	2001	2000	1999
<b>Cash Flows from Operating Activities</b>			
Net income	\$ 1,416	\$ 1,115	\$ 814
Adjustments to reconcile net income to net cash from operating activities:			
Equity in undistributed net income of subsidiary	(1,211)	(972)	(618)
Change in other assets	75	(47)	(6)
Change in other liabilities	(13)	76	3
<b>Net cash provided by operating activities</b>	<b>267</b>	<b>172</b>	<b>193</b>
<b>Cash Flows from Investing Activities</b>			
Capital downstreamed to subsidiary	(2,750)	(1,950)	(1,325)
<b>Cash Flows from Financing Activities</b>			
Net change in short-term borrowings	(911)	1,694	1,225
Dividends paid to stockholders	(192)	(103)	(93)
Stock redemption	-	(6)	(4)
Proceeds from issuance of common stock, net of offering expenses	3,517	345	-
<b>Net cash provided by financing activities</b>	<b>2,414</b>	<b>1,930</b>	<b>1,128</b>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>(69)</b>	<b>152</b>	<b>(4)</b>
Cash and Cash Equivalents - Beginning of year	159	7	11
<b>Cash and Cash Equivalents - End of year</b>	<b>\$ 90</b>	<b>\$ 159</b>	<b>\$ 7</b>

# Management's Discussion and Analysis of Financial Condition or Plan of Operation

The following "Management's Discussion and Analysis of Financial Condition or Plan of Operation" is intended to assist in understanding the results of operations of the Corporation. The information contained in this section should be read in conjunction with the consolidated financial statements and accompanying notes contained in this report.

The Corporation is not aware of any market or institutional trends, events, or circumstances that will have or are reasonably likely to have a material effect on liquidity, capital resources, or results of operations except as discussed herein. Also, the Corporation is not aware of any current recommendations by regulatory authorities which will have such affect if implemented.

## FORWARD LOOKING STATEMENTS

In addition to historical information, the following "Management's Discussion and Analysis of Financial Condition or Plan of Operation" contains "forward-looking statements" that involve risks and uncertainties. All statements regarding the expected financial position, business, and strategies are forward-looking statements and the Corporation intends for them to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. The words "anticipates," "believes," "estimates," "seeks," "expects," "plans," "intends," and similar expressions, as they relate to the Corporation or management, are intended to identify forward-looking statements. Although the Corporation believes that the expectations reflected in these forward-looking statements are reasonable, and have based these expectations on beliefs and assumptions that have been made, these expectations may prove to be incorrect. Important factors that could cause actual results to differ materially from expectations, include, without limitation, the failure of a significant number of borrowers to repay their loans, general changes in eco-

nomic conditions and interest rates, as well as restrictions imposed by regulations or regulators of the banking industry.

## FINANCIAL HIGHLIGHTS

Total assets increased by \$54,521,000 or 41% from December 31, 2000 to December 31, 2001. This increase was primarily the result of an increase in loans of \$46,070,000 since December 31, 2000. To fund the loan increase, deposits increased by \$50,966,000 since December 31, 2000. Year-to-date consolidated net income was \$1,416,000 through December 31, 2001 compared to \$1,115,000 for the same period in 2000. Basic earnings per share were \$3.12 for the year ended December 31, 2001 compared to \$3.57 for the year ended December 31, 2000. The increase in net income accompanied by a decrease in earnings per share was due to a stock offering conducted by the Corporation during the second quarter of 2001.

## FINANCIAL CONDITION

### Investments

Total investments, including securities available for sale, securities held to maturity, and other securities, were \$19,739,000 at

December 31, 2001, as compared to \$15,402,000 at December 31, 2000. The increase of \$4,337,000, or 28%, is primarily the result of increased cash flows available from deposits exceeding the cash required to fund loans. Held to maturity securities declined to \$1,042,000 at December 31, 2001 from \$2,952,000 at December 31, 2000. Investment securities that management has the positive intent and ability to hold to maturity are classified as "held to maturity" and recorded at amortized cost. Except in limited situations, securities classified as held to maturity cannot be sold before maturity and still be recorded at amortized cost. The decrease in held to maturity securities was attributable to management's strategy to position a larger portion of the investment securities portfolio as available for sale to increase liquidity and interest rate risk management options. Investment securities provide a source of liquidity as well as a means to diversify the risk inherent in the balance sheet. See Note 2 to the Consolidated Financial Statements included elsewhere in this report for more detail on the investment portfolio.

Following is a summary of the loan mix at December 31, 2001 and 2000 (000s omitted).

	2001		2000	
	Amount	Percent of Total Loans	Amount	Percent of Total Loans
Mortgage loans on real estate				
Residential 1-4 family	\$ 54,694	34.8 %	\$ 33,601	30.3 %
Construction	12,434	7.9 %	5,244	4.7 %
Second mortgage	4,166	2.7 %	6,050	5.5 %
Equity lines of credit	1,505	1.0 %	1,339	1.2 %
Commercial	26,193	16.7 %	20,264	18.2 %
Commercial loans	17,936	11.4 %	10,585	9.5 %
Consumer installment loans				
Personal	39,823	25.3 %	33,634	30.3 %
Personal lines of credit	355	0.2 %	319	0.3 %
<b>TOTAL</b>	<b>\$ 157,106</b>	<b>100.0 %</b>	<b>\$ 111,036</b>	<b>100.0 %</b>



# Management's Discussion and Analysis of Financial Condition or Plan of Operation

## Loans and Allowance for Loans Losses

The Corporation's loan portfolio increased by \$46,070,000, or 41%, from \$111,036,000 at December 31, 2000 to \$157,106,000 at December 31, 2001. Growth in the portfolio came from all areas with residential mortgages registering the largest increase. Residential mortgages increased by \$21,093,000 or 63% from \$33,601,000 at December 31, 2000 to \$54,694,000 at December 31, 2001. Commercial loans secured by real estate increased by \$5,929,000 or 29% from \$20,264,000 at December 31, 2000 to \$26,193,000 at December 31, 2001. Non real estate-related commercial loans increased by \$7,351,000 or 69% from \$10,585,000 at December 31, 2000 to \$17,936,000 at December 31, 2001.

The Corporation has experienced significant loan growth through a combination of events. First, management has endeavored to structure human and technological resources to provide products and services at a level that competitors may not necessarily provide. Second, management has structured its loan approval procedures and product guidelines to achieve higher customer service objectives without sacrificing quality considerations. Third, various competitors have experienced mergers or restructurings that may have affected their service capabilities in various manners. The Corporation's management believes that its strategies for human and technological resources, loan approval procedures and product development, coupled with competitors' varying situations, created the environment where accelerated loan growth was possible. Management has not relaxed underwriting guidelines, entered new lines of businesses, developed new loan products of a significant nature, or entered new geographic markets. Management's strategy for growth is to offer more personalized service for basic, traditional loan and deposit products.

As noted on the previous page, while each individual loan portfolio has increased significantly, the overall mix of the loan portfolio has changed only moderately. Loans secured by 1-4 family real estate mortgages represents 34.8% of the loan portfolio at December 31, 2001 compared to 30.3% at December 31, 2000. Loans for construction of 1-4 family residences also increased, from 4.7% of the loan portfolio at December 31, 2000 to 7.9% at December 31, 2001. The proportion of the loan portfolio represented by consumer installment loans declined from 30.3% at December 31, 2000 to 25.3% at December 31, 2001. Management's strategy is to maintain a loan portfolio that is diversified at current proportional levels. While moderate changes to the overall mix of loans will occur, management believes a diversified loan portfolio decreases risk as it relates to economic conditions, the interest rate environment and liquidity risk.

The Corporation generally places commercial loans on non-accrual status when the loan is past due as to the payment of interest and/or principal in excess of 90 days. The Corporation also places commercial loans on non-accrual status when it deems the collection of such interest unlikely. Loans are returned to a full accrual status when the loan is brought current according to all terms of the loan agreement, all past due principal and interest is paid and the

Corporation deems its collateral position adequate to warrant a return to accrual status. Consumer loans are not typically placed on non-accrual status, but written off against the allowance for loan losses when the loan reaches 90 days past due or when full collection is deemed unlikely. Residential mortgage loans in the process of foreclosure are placed on non-accrual status when management determines that collection of all principal and interest owed is unlikely.

At December 31, 2001, non-performing loans - which include nonaccrual loans and loans 90 or more days past due and still accruing - totaled \$826,000. The nonaccrual loans of \$513,000 were comprised of eight loans to five customers while the loans 90 or more days past due of \$313,000 were comprised of 18 loans. While nonperforming loans have increased from December 31, 2000 to December 31, 2001, management believes the level of such loans is manageable. Management fully expects that diligent servicing of these loans will minimize delinquencies and losses.

The Corporation had no troubled debt restructurings as of December 31, 2001 and 2000.

Management is not aware of any potential problem loans which management believes could have a material effect on the Corporation's operating results, liquidity, or capital resources.

**The following table shows the detail of non-performing loans as of December 31, 2001 and 2000 (000s omitted).**

	2001	2000
Non-accrual loans	\$ 513	\$ 90
Loans past due 90 or more days	313	55
Total non-performing loans	<u>\$ 826</u>	<u>\$ 145</u>
Total non-performing loans to total loans	0.52 %	0.13 %

# Management's Discussion and Analysis of Financial Condition or Plan of Operation

The following highlights the allocations of allowances for loan losses as of December 31, 2001 and 2000 (000s omitted).

	2001		2000	
	Allowance for Loan Losses	Percent of Total Allowance	Allowance for Loan Losses	Percent of Total Allowance
Domestic:				
Commercial loans	\$ 352	28.7 %	\$ 181	21.5 %
Residential real estate mortgages	37	3.0 %	24	2.8 %
Consumer loans	511	41.6 %	449	53.3 %
Lease financing	—	n/a	—	n/a
Foreign	—	n/a	—	n/a
Unallocated	328	26.7 %	189	22.4 %
<b>TOTAL</b>	<b>\$ 1,228</b>	<b>100.0 %</b>	<b>\$ 843</b>	<b>100.0 %</b>

The allowance for loan losses as a percentage of total loans was .78% at December 31, 2001, compared to .76% at December 31, 2000. The unallocated portion of the allowance for loan losses as a percentage of the entire allowance for loan losses was 27% at December 31, 2001 compared to 22% at December 31, 2000.

Loan quality is continually and systematically monitored and reviewed by management on a monthly basis. In determining the provision for loan losses, management first determines the estimated allowance for loan losses required for any specifically identified problem loans graded watch, substandard or doubtful. To this, management estimates and adds potential charge-offs using an average of the last five years' historical charge-offs by loan category. Management then may add, at its discretion, a factor to the historical charge-off ratios to adjust for current economic conditions or other factors such as loan delinquencies and the perceived credit risk in the portfolio. The unallocated portion of the allowance for loan losses involves the exercise of judgment by management and reflects various considerations, including management's view that the allowance for loan losses should have a margin that recognizes the imprecision inherent in the process of estimating credit losses. Management increased the unallocated por-

tion of the allowance for loan losses as of December 31, 2001 to \$328,000 from \$189,000 at December 31, 2000 based upon its perception of weakening economic conditions, and to provide for an additional provision for the rapid increase in loans during the period. Management believes this increase is prudent since many of the recently added loans have not "seasoned" and thus may not be accurately reflected in the estimates using the historical charge-off percentages.

Management maintains an allowance for loan losses believed to be sufficient to absorb credit losses inherent in the loan portfolio. The allowance for loan losses represents management's estimate of probable loan losses in the portfolio at each balance sheet date and is supported by all available and relevant information. The allowance for loan losses contains provisions for probable losses that have been identified relating to specific borrowing relationships as well as probable losses believed to be inherent in the loan portfolio and loan relationships not specifically identified. Management also takes into consideration the high percentage of residential mortgage loans in the loan portfolio, which generally have a lower risk of loss compared to other types of loans. Management believes that the allowance for loan losses is adequate to provide for esti-

mated probable credit losses inherent in the loan portfolio.

## Deposits

Total deposits increased \$50,996,000, or 60%, from \$85,652,000 at December 31, 2000 to \$136,618,000 at December 31, 2001. Management has instituted an aggressive campaign to increase the core deposit base from local sources as a means to fund strong loan demand. In addition to obtaining deposits in the Corporation's local market area, out-of-market certificates of deposit were attracted through a national market system. Out-of-market certificates of deposit were the source of a majority of the Corporation's deposit growth. Growth in out-of-market certificates of deposit accounted for 61% of overall deposit growth or \$31,111,000. At December 31, 2001 out-of-market certificates of deposit totaled \$45,169,000 compared to \$14,058,000 at December 31, 2000. Overall, out-of-market certificates of deposit represent 33% of total deposits.

Local deposit growth, despite continuing efforts to generate more growth, has not reached the same level as loan growth. Management is confident that, over the long-term, local deposit growth will more closely match loan growth. Management attributes lower local deposit growth to customer perceptions that it is inconvenient to switch checking accounts to a new bank. Management plans to continue deposit growth initiatives in the Corporation's local market. Management is also evaluating new branching opportunities as a means of generating additional deposit growth. Management anticipates that the Corporation's reliance on out-of-market certificates of deposit will continue at current levels for the foreseeable future.

## Other Borrowings

The Corporation utilizes other sources of funding to accommodate asset growth. The Corporation has a \$4,000,000 line of credit from another bank which is secured by the

# Management's Discussion and Analysis of Financial Condition or Plan of Operation

Details of the outstanding borrowings of the Corporation as of December 31, 2001 and 2000 are contained in the following table (000s omitted):

Type	Year Matures	2001		2000	
		Amount	Average Rate	Amount	Average Rate
Bank Line of Credit	2001	-	-	\$ 3,050	9.00 %
	2002	\$ 2,139	4.25 %	-	-
FHLB Line of Credit	2001	-	-	3,399	6.30 %
	2002	-	1.82 %	-	-
FHLB Term Advances	2001	-	-	12,761	6.75 %
	2002	14,461	6.12 %	10,963	6.64 %
	2003	8,885	5.60 %	5,557	6.42 %
	2004	4,875	6.46 %	3,022	6.59 %
	2005	5,411	5.27 %	1,500	6.49 %
	2006	3,500	5.04 %	-	-

stock of First National Bank of Gaylord. This line is generally renewed on an annual basis and carries interest at the bank's prime rate less 0.50 percent. In addition, the Corporation maintains a \$5,000,000 line of credit for short-term liquidity requirements at the Federal Home Loan Bank of Indianapolis (FHLB). The interest rate on this line of credit is variable and changes daily.

The Corporation has pledged U.S. Treasury securities and U.S. government-sponsored agencies' securities and certain real estate loans as collateral for the line of credit and term advances at the FHLB. As of December 31, 2001, securities with a carrying value of \$6,887,000 (market value of \$7,024,000) were pledged. Additionally, \$52,357,000 of 1-4 family residential mortgage loans and \$3,538,000 of real estate loans secured by second mortgages were pledged as collateral to the FHLB.

## Capital

The Corporation's total stockholders' equity increased \$4,811,000 or 80% for the year ended December 31, 2001 to \$10,798,000 at December 31, 2001 from \$5,987,000 at December 31, 2000. Funds from the stock offering accounted for 73% or \$3,517,000 (net of \$409,000 in offering

expenses) of the increase in stockholders' equity. The remainder of the increase in stockholders' equity came from net income in 2001 (25%, net of cash dividends to stockholders) and 2% from changes in accumulated other comprehensive income.

To be considered a "well-capitalized" bank by the FDIC, the institution must have a total risk-based capital ratio of at least 10%, a Tier 1 capital ratio of at least 6%, and a leverage ratio of at least 5%, and must not be subject to any written agreement from any regulatory agency requiring it to meet or maintain any specific capital levels. As of December 31, 2001 the Bank was considered well-capitalized. See Note 16 to the Consolidated Financial Statements included elsewhere in this report.

## RESULTS OF OPERATIONS

### Net Interest Income

Net interest income for the year ended December 31, 2001 totaled \$6,353,000 and represented an increase of \$1,698,000, or 36%, compared to the same period one year ago. The increase in net interest income was primarily attributable to the increase in the volume of loans; however, this increase was offset by an increase in deposits. The Corporation's net interest

margin (on a tax equivalent basis) narrowed from 4.43% for the year ended December 31, 2000 to 4.26% for the year ended December 31, 2001. The net interest margin has been impacted by the current economic conditions as well as the competitive nature of the Corporation's market. The Corporation, along with its competitors, has experienced tighter interest margins as lending rates decreased at a faster pace than deposit and borrowing rates. Interest income from loans represented 93% of total interest income for the year ended December 31, 2001 compared to 92% for the same period in 2000.

The following table presents the Corporation's consolidated average balances of interest earning assets, interest bearing liabilities, and the amount of interest income or interest expense attributable to each category, the average yield or rate for each category, and the net interest margin for the years ended December 31, 2001, 2000, and 1999 (000s omitted). Average loans are presented net of unearned income and gross of the allowance for loan losses. Interest on loans includes loan fees. Interest income is presented on a tax-equivalent basis.

# Management's Discussion and Analysis of Financial Condition or Plan of Operation

	2001			2000			1999		
	Average Balance	Interest	Rate	Average Balance	Interest	Rate	Average Balance	Interest	Rate
Federal funds sold	\$ 493	\$ 18	3.65 %	\$ 89	\$ 8	8.99 %	\$ 644	\$ 31	4.81 %
Investment securities-taxable	14,043	814	5.80 %	11,826	740	6.26 %	11,418	683	5.98 %
Investment securities-tax-exempt	2,404	150	6.24 %	1,589	114	7.17 %	1,165	71	6.09 %
Loans, net of unearned income	133,417	12,590	9.44 %	92,438	8,889	9.62 %	56,137	5,110	9.10 %
Total earning assets	\$ 150,357	\$ 13,572	9.03 %	\$ 105,942	\$ 9,751	9.20 %	\$ 69,364	\$ 5,895	8.50 %
Interest bearing deposits	\$ 93,674	\$ 4,722	5.04 %	\$ 63,819	\$ 3,121	4.89 %	\$ 51,204	\$ 2,006	3.92 %
Borrowed funds	38,595	2,446	6.34 %	29,040	1,936	6.67 %	7,707	401	5.20 %
Total interest bearing liabilities	\$ 132,269	\$ 7,168	5.42 %	\$ 92,859	\$ 5,057	5.45 %	\$ 58,911	\$ 2,407	4.09 %
Net interest income		\$ 6,404			\$ 4,694			\$ 3,488	
Net interest spread			3.61 %			3.75 %			4.41 %
Net interest margin			4.26 %			4.43 %			5.03 %

The following table presents the extent to which changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities have affected the Corporation's interest income and interest expense during the years indicated.

Information is provided in each category with respect to: (i) changes attributable to changes in volume (changes in volume multiplied by prior rate); (ii) changes attributable to changes in rate (changes in rate multiplied by prior volume); and (iii) the net change (the

sum of the prior columns). The changes attributable to the combined impact of volume and rate have been allocated on a proportional basis between changes in rate and volume (000s omitted).

	2001 Compared to 2000			2000 Compared to 1999		
	Increase (Decrease) Due to			Increase (Decrease) Due to		
	Rate	Volume	Net	Rate	Volume	Net
Federal funds sold	\$ (7)	\$ 17	\$ 10	\$ 15	\$ (38)	\$ (23)
Investment securities-taxable	(57)	131	74	32	25	57
Investment securities-tax-exempt	(16)	52	36	14	29	43
Loans, net of unearned income	(169)	3,870	3,701	303	3,476	3,779
Total interest earning assets	(249)	4,070	3,821	364	3,492	3,856
Interest bearing deposits	99	1,502	1,601	560	555	1,115
Borrowed funds	(100)	610	510	142	1,393	1,535
Total interest bearing liabilities	(1)	2,112	2,111	702	1,948	2,650
Increase (decrease) in net interest income	\$ (248)	\$ 1,958	\$ 1,710	\$ (338)	\$ 1,544	\$ 1,206

## Provision for Loan Losses

The provision for loan losses charged to operations was \$886,000 for the year ended December 31, 2001 as compared to \$523,000 for the year ended December 31, 2000. Net charge-offs for the year ended

December 31, 2001 totaled \$501,000 as compared to \$260,000 for the same period of 2000. The increase in the provision for loan losses during the year is the result of the increase in net charge-offs as well as increased loan growth and evidence of

adverse economic indicators in the overall economy.

## Other Income

Other income increased by \$436,000 to \$1,332,000 for the year ended December 31, 2001 as compared to

# Management's Discussion and Analysis of Financial Condition or Plan of Operation

The activity in the allowance for loan losses for the years ended December 31, 2001 and 2000 is presented in the following table (000s omitted):

	2001	2000
	\$ 843	\$ 580
Balance – beginning of year		
Loans charged-off:		
Commercial loans	47	17
Real estate mortgage loans	–	–
Consumer loans	554	315
Total charge-offs	601	332
Recoveries:		
Commercial loans	3	15
Real estate mortgage loans	–	5
Consumer loans	97	52
Total recoveries	100	72
Provision for loan losses	886	523
Balance – end of year	\$ 1,228	\$ 843

\$896,000 for the year ended December 31, 2000. The increase in other income was primarily due to the increased activity on the sale of real estate mortgage loans originated for sale. The gain on the sale of such loans was \$517,000 for the year ended December 31, 2001 as compared to \$105,000 for the year ended December 31, 2000. The income recognized in connection with the recording of the mortgage servicing rights asset for these loans sold was \$388,000 for the year ended December 31, 2001 as compared to \$78,000 for 2000.

The Corporation generally sells all 15- to 30-year, fixed rate, residential real estate loans it originates and receives a gain on the sale of such loans. In addition, since the loans are sold with servicing retained, the Corporation records the servicing asset at the time the loans are sold. With the decreasing interest rate environment experienced during 2001, activity in mortgage refinancings increased, resulting in increased income to the Corporation. The Bank does, from time to time, hold long-term fixed rate loans for its portfolio. In 2001 a significant amount of long-term fixed rate loans were added to the portfolio. Management, therefore, developed appropriate funding and pricing strategies.

## Other Expense

Other expenses increased by \$1,307,000 to \$4,686,000 for the year ended December 31, 2001 as compared to \$3,379,000 for the year ended December 31, 2000. Personnel costs increased by \$486,000, or 28%, to \$2,197,000 for the year ended December 31, 2001 as personnel was added to support the Corporation's continued growth. Equipment and data processing expense increased by \$101,000 to \$412,000 for the year ended December 31, 2001 as compared to the same period in 2000; this increase related to increases in depreciation expense and equipment repairs and maintenance and the acquisition of a new digital check imaging system to handle increased transaction volume. Professional fees increased by \$164,000 to \$260,000 for the year ended December 31, 2001 as compared to \$96,000 a year ago; this increase is attributable to increased legal and accounting requirements connected with the various requirements associated with Securities and Exchange Commission reporting. Office supplies and postage increased by \$75,000 to \$206,000 for the year ended December 31, 2001 as compared to \$131,000 a year ago. This

increase, along with other such increases, are due to the overall growth of the Corporation.

## Federal Income Tax Expense

The provision for federal income tax was 33% of pretax income for the year ended December 31, 2001 as compared to 32% for 2000.

The difference between the effective tax rates and the federal corporate income tax rate of 34% is primarily due to tax-exempt interest earned on investments and loans.

## Net Income

Net income totaled \$1,416,000 for the year ended December 31, 2001 as compared to \$1,115,000 for 2000. Basic earnings per share totaled \$3.12 for the year ended December 31, 2001 as compared to \$3.57 for the year ended December 31, 2000. Per share earnings were affected by additional stock issued in the second quarter of 2001. The Corporation does not have any dilutive stock plans; therefore, basic and dilutive earnings per share are the same.

# Management's Discussion and Analysis of Financial Condition or Plan of Operation

## LIQUIDITY

At December 31, 2001, the Corporation held cash and cash equivalents of \$7,232,000 and \$16,363,000 of the Corporation's investment securities were classified as available for sale. The amortized cost of the available for sale securities was less than the fair value at year-end, primarily as the result of decreasing interest rates, which resulted in an unrealized gain within the investment portfolio. Management does not believe the sale of any of the Corporation's securities would materially affect the overall financial condition of the Corporation.

The primary impact of inflation on the Corporation's operations is increased asset yields, deposit costs and operating over-

head. Unlike most industrial companies, virtually all of the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates generally have a more significant impact on a financial institution's performance than they would on non-financial companies. Although interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services, increases in inflation generally have resulted in increased interest rates. The effects of inflation can magnify the growth of assets and if significant, require that equity capital increase at a faster rate than would otherwise be necessary.

Managing rates on interest earning assets and interest bearing liabilities focuses

on maintaining the net interest margin, an important factor in earnings growth and stability. Emphasis is placed on maintaining a controlled rate sensitivity position, to avoid wide swings in margins and to manage risk due to changes in interest rates.

The following table shows the maturity and repricing distribution of the Corporation's interest earning assets and interest bearing liabilities at December 31, 2001 (000s omitted). The table displays the interest rate sensitivity gap (i.e., interest rate sensitive assets less interest rate sensitive liabilities), cumulative interest rate sensitivity gap, the interest rate sensitivity gap ratio (i.e., interest rate sensitive assets divided by interest rate sensitive liabilities), and the cumulative interest rate sensitivity gap ratio.

	Within 3 Months	After 3 Months but Within 1 Year	After 1 Year but Within 5 Years	Over 5 Years	Total
<b>Interest-earning assets:</b>					
Loans	\$ 13,548	\$ 14,451	\$ 68,968	\$ 60,139	\$ 157,106
Investments	823	2,630	11,854	4,239	19,546
Federal Funds Sold	1,383	-	-	-	1,383
Total interest-earning assets	\$ 15,754	\$ 17,081	\$ 80,822	\$ 64,378	\$ 178,035
<b>Interest-bearing liabilities:</b>					
Interest-bearing demand	\$ -	\$ 3,507	\$ -	\$ 10,522	\$ 14,029
Savings and money market	1,877	4,693	1,877	10,326	18,773
Time deposits < \$100,000	6,398	29,340	23,400	-	59,138
Time deposits > \$100,000	3,340	10,130	13,244	-	26,714
Short-term borrowings	-	2,139	-	-	2,139
Notes payable	3,792	10,669	22,671	-	37,132
Total interest-bearing liabilities	\$ 15,407	\$ 60,478	\$ 61,192	\$ 20,848	\$ 157,925
<b>Period:</b>					
Rate sensitive assets (RSA)	\$ 15,754	\$ 17,081	\$ 80,822	\$ 64,378	
Rate sensitive liabilities (RSL)	15,407	60,478	61,192	20,848	
Interest rate sensitivity GAP (RSA-RSL)	\$ 347	\$ (43,397)	\$ 19,630	\$ 43,530	
Interest rate sensitivity GAP ratio	1.02	0.28	1.32	3.09	
<b>Cumulative:</b>					
Rate sensitive assets (RSA)	\$ 15,754	\$ 32,835	\$ 113,657	\$ 178,035	
Rate sensitive liabilities (RSL)	15,407	75,885	137,077	157,925	
Interest rate sensitivity GAP (RSA-RSL)	\$ 347	\$ (43,050)	\$ (23,420)	\$ 20,110	
Interest rate sensitivity GAP ratio	1.02	0.43	0.83	1.13	

# Selected Quarterly Financial Data *Unaudited*

000s omitted, except per share data.  
For the Quarters Ended

2001	March 31	June 30	September 30	December 31
<b>Selected Operations Data:</b>				
Interest income	\$ 2,961	\$ 3,366	\$ 3,495	\$ 3,699
Interest expense	(1,676)	(1,792)	(1,833)	(1,867)
Net interest income	1,285	1,574	1,662	1,832
Provision for loan losses	(99)	(256)	(224)	(307)
Net interest income after provision for loan losses	1,186	1,318	1,438	1,525
Other income	294	333	268	437
Other expenses	(978)	(1,148)	(1,115)	(1,445)
Federal income tax expense	(182)	(143)	(199)	(173)
Net income	\$ 320	\$ 360	\$ 392	\$ 344
<b>Per Share Data:</b>				
Earnings per share	\$ 0.88	\$ 0.84	\$ 0.75	\$ 0.65
Dividends per share	0.10	0.10	0.10	0.10
<b>Stock Price Data:</b>				
Number of shares traded	334	1,074	3,500	70
Average price per share	\$ 19.50	\$ 19.75	\$ 25.00	\$ 23.00
<b>2000</b>				
<b>Selected Operations Data:</b>				
Interest income	\$ 1,942	\$ 2,279	\$ 2,604	\$ 2,887
Interest expense	(939)	(1,163)	(1,397)	(1,558)
Net interest income	1,003	1,116	1,207	1,329
Provision for loan losses	(84)	(121)	(134)	(184)
Net interest income after provision for loan losses	919	995	1,073	1,145
Other income	184	261	203	248
Other expenses	(767)	(834)	(856)	(922)
Federal income tax expense	(120)	(152)	(127)	(135)
Net income	\$ 216	\$ 270	\$ 293	\$ 336
<b>Per Share Data (1):</b>				
Earnings per share	\$ 0.70	\$ 0.87	\$ 0.95	\$ 1.05
Dividends per share	0.10	0.13	—	0.10
<b>Stock Price Data (1):</b>				
Number of shares traded	3,122	1,310	none	1,000
Average price per share	\$ 13.50	\$ 16.83	n/a	\$ 17.50

(1) Adjusted for the 5-for-4 stock split declared March 24, 2000 and the 2-for-1 stock split declared June 23, 2000. Stock price data are based upon sales which have come to the attention of the Corporation's management. Because shares are sold infrequently, and not on any exchange, the data shown are not necessarily an accurate reflection of the true market value. Shares may also have been sold in transactions, the price and terms of which are not known to the Corporation.

## North Bancorp, Inc. Directors



**Matthew H. Nowicki**  
Chairman  
President, M & M Excavating, Inc.



**Fred T. Burns**  
President, Burns Plumbing & Heating, Inc.



**Clare R. Colwell**  
Vice President and Commercial Loan Manager,  
Ionia County National Bank



**Keith Hardin Gornick**  
President, Otsego Club and Resort



**Larry B. Higgins**  
President, H & H Tube Manufacturing, Inc.



**Douglas C. Johnson**  
President, Mid-North Printing, Inc.



**John R. Kluck**  
President and Chief Executive Officer,  
North Bancorp, Inc.

## First National Bank of Gaylord Officers

**John R. Kluck**  
President and Chief  
Executive Officer

**William A. Kirsten**  
Senior Vice President &  
Chief Financial Officer

**Steven D. Riozzi**  
Senior Vice President &  
Senior Lending Officer

**Katherine L. Taskey**  
Vice President, Operations

**Sherri K. Quay**  
Vice President, Mortgages

**Susan A. Norris**  
Vice President,  
Information Systems  
Manager

**Janet M. Luczak**  
Vice President, Mortgages

**Keith E. Kenney**  
Vice President, Lending

**Elizabeth A. Mench**  
Business Development  
Officer

**Mary C. Fitzek**  
Branch Operations Officer

**Marilyn A. Cousineau**  
Loan Officer

**Corenne M. Ching**  
Collections Officer

## North Bancorp, Inc. Officers

**John R. Kluck**  
President and Chief Executive Officer

**William A. Kirsten**  
Senior Vice President

**Steven D. Riozzi**  
Senior Vice President



# First National Bank of Gaylord Associates

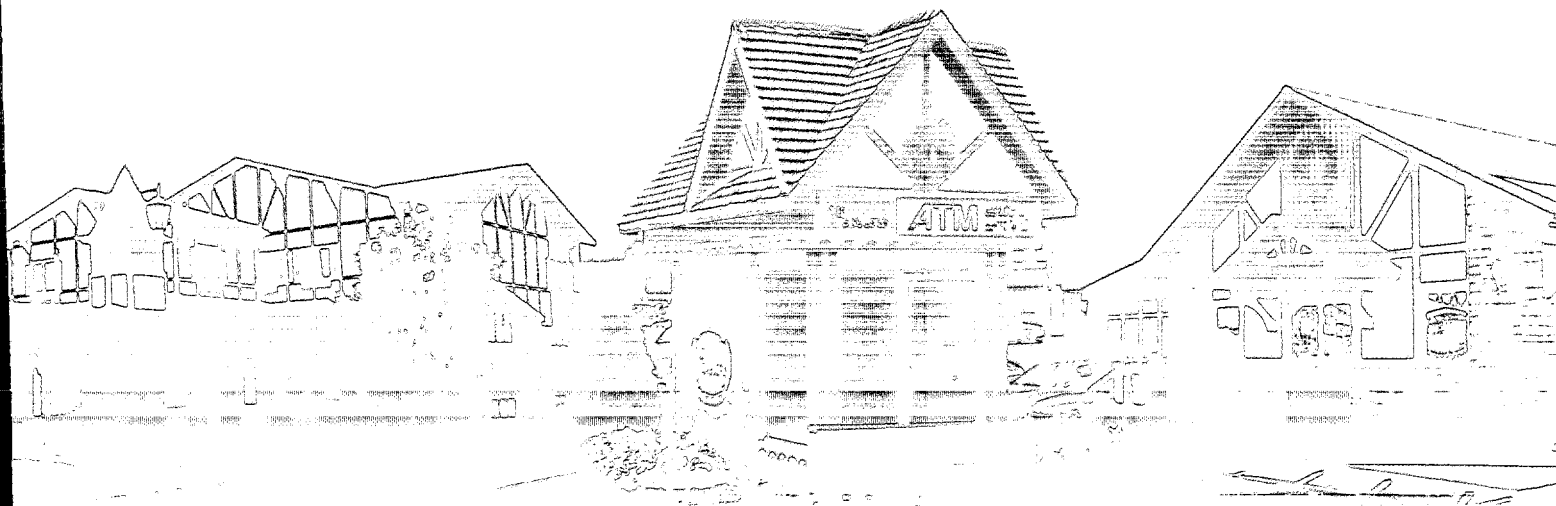
# Directors Emeriti

Debra Altman  
Pam Awrey  
Crystal Babcock  
Betty Ballou  
Kathleen Barajas  
Brad Berlin  
Nancy Bottomley  
Stephanie Brennan  
Ashley Burill  
Amanda Caroen  
Shannon Chesner  
Michelle Church  
Charlotte Cross  
Shannon Cruse  
Diane Dobrosielski  
Elaine Dobrzelewski  
Eleanor Fleetwood

Renee Flickinger  
Sally Gapinski  
Janet Harrison  
Desi Hebel  
Danielle Johnson  
Chris Kasper  
Cynthia Kirsten  
Pamela Koronka  
Sandy Kroll  
Lowell Kussrow  
Julia Kwapis  
Terry Lake  
Marcia Leitelt  
Karen Meteer  
Kathi Mills  
Kathy Muzyl  
Amy Palmer

Kera Platte  
Cindee Polena  
Linda Popp  
Maria Renkiewicz  
Shannon Richardson  
Leeann Roemer  
Renee Rudel  
Jack Samkowiak  
Bonnie Shunatona  
Kim Smith  
Kim Stuart  
Katie Walcott  
Ken Williamson  
Carol Wonderly  
Melissa Valdez  
Polly Zanger

Victor Borowiak  
Walter Drzewiecki  
Conrad Schaffer  
Robert Weaver  
Willis Wegmeyer



# Notice of Availability

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A copy of North Bancorp, Inc.'s SEC Form 10-KSB, including financial statements and financial statement schedules, may be obtained without charge by submitting a written request to:

**William A. Kirsten**

*Senior Vice President and Chief Financial Officer*

**North Bancorp, Inc.**

**P.O. Box 310**

**Gaylord, MI 49734**

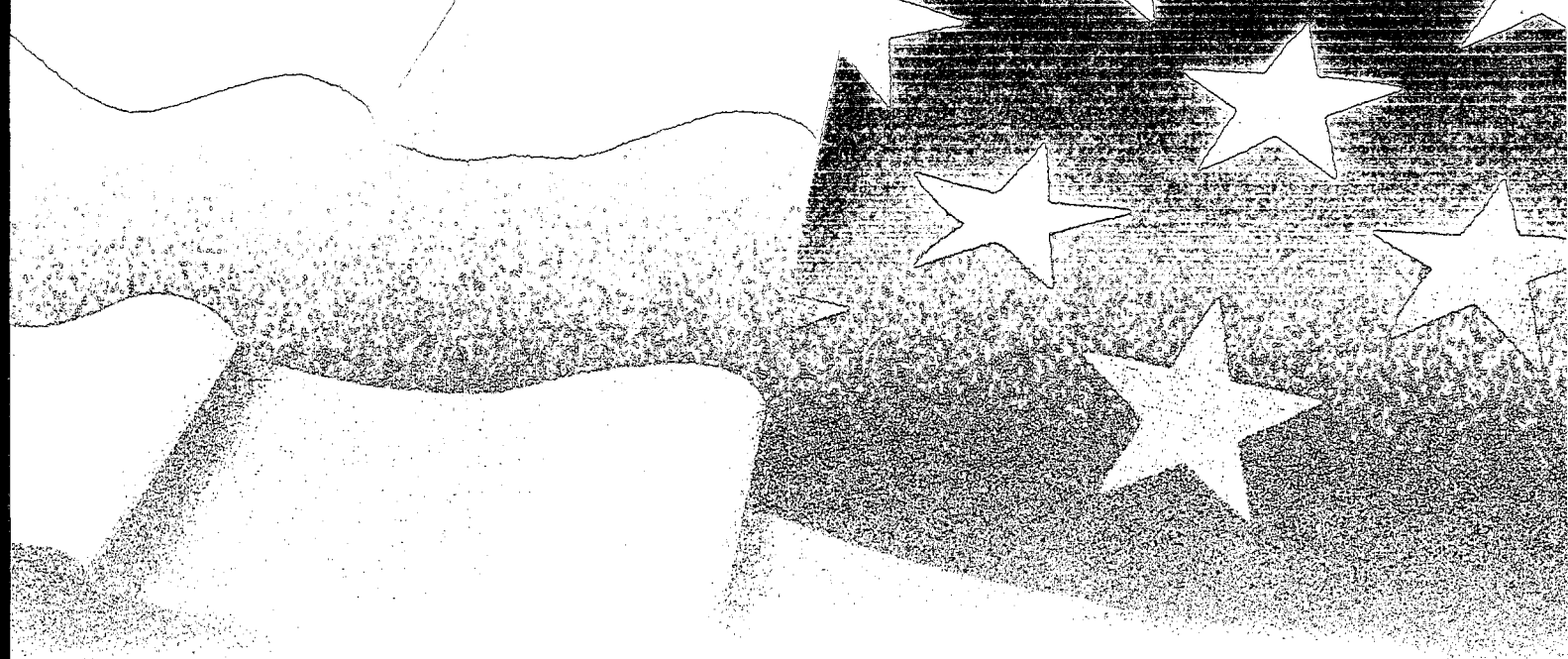
## Shareholder Information


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The Corporation's common stock is traded primarily in Michigan. There is no formal market for the stock. At December 31, 2001, the Corporation had approximately 777 shareholders of record.

First National Bank of Gaylord's capital management policy allows for cash dividends to be paid to the Corporation. The Corporation is primarily dependent upon dividends from the Bank for funds to pay dividends on common stock to its shareholders. See Note 17 to the Corporation's consolidated financial statements appearing elsewhere in this Annual Report for information concerning regulatory restrictions on dividends paid by the Bank to the Corporation.

The number of shares traded, average price per share, and amount and frequency of dividends declared by the Corporation for each quarter during the years ended December 31, 2001 and 2000 are contained in the table captioned "Selected Quarterly Financial Data" appearing elsewhere in this Annual Report.



Member FDIC - Equal Opportunity Lender 

North Bancorp, Inc.  
501 West Main Street  
P.O. Box 310  
Gaylord, Michigan 49735-0310  
989.732.3502